

**LEGISLATIVE SERVICES AGENCY  
OFFICE OF FISCAL AND MANAGEMENT ANALYSIS**

200 W. Washington, Suite 301  
Indianapolis, IN 46204  
(317) 233-0696  
<http://www.in.gov/legislative>

**FISCAL IMPACT STATEMENT**

**LS 6334**

**BILL NUMBER:** SB 125

**NOTE PREPARED:** Dec 5, 2002

**BILL AMENDED:**

**SUBJECT:** Phase out of Inheritance Tax.

**FIRST AUTHOR:** Sen. Ford

**FIRST SPONSOR:**

**BILL STATUS:** As Introduced

**FUNDS AFFECTED:** X GENERAL  
X DEDICATED  
FEDERAL

**IMPACT:** State & Local

**Summary of Legislation:** The bill phases out the Inheritance Tax over a five year period beginning July 1, 2003, by giving an increasing credit against the Inheritance Tax due. The bill also provides that the Indiana Estate Tax formula does not apply to the estate of a person who dies after June 30, 2005.

**Effective Date:** July 1, 2003.

**Summary of Net State Impact:** Under the bill, the state will experience a progressively larger reduction in Inheritance Tax revenue from FY 2005 to FY 2009, when it is estimated the state will no longer receive revenue from the tax. However, the bill could potentially lead to a slight increase in Estate Tax revenue in FY 2005 and FY 2006. The bill is also expected to increase state General Fund expenditures on county Inheritance Tax replacement. The net state impact of the bill is summarized in the table below. (These estimates will be updated as new forecast totals and new tax data become available.)

<b>Fiscal Year</b>	<b>Inheritance Tax Revenues</b>	<b>Estate Tax Revenues</b>	<b>State Expenditures for County Replacement</b>	<b>Net Increase (Decrease)</b>
<b>2005</b>	(\$24.0 M)	\$328,000	(\$255,000 - \$2.1 M)	(\$24.0 - \$25.8 M)
<b>2006</b>	(48.1 M)	52,000	(1.4 - 4.1 M)	(49.4 - 52.1 M)
<b>2007</b>	(72.1 M)	0	(3.2 - 6.2 M)	(75.3 - 78.3 M)
<b>2008</b>	(96.1 M)	0	(5.2 - 7.5 M)	(101.3 - 103.6)
<b>2009 and after</b>	(120.1 M)	0	(7.5 M)	(127.6 M)

**Explanation of State Expenditures:** *Department of State Revenue:* Once the Inheritance Tax is repealed, there could be a savings to the state from a reduction in staff in the Inheritance Tax Section of the Department of State Revenue. The October 2, 2002, state staffing table indicates that the Inheritance Tax Section has 16 full-time positions with an annual salary cost of \$398,000. Since staff members would still be needed to process returns, a specific savings due to staff reductions could not be estimated.

*County Inheritance Tax Replacement:* The bill could potentially increase expenditures from the state General Fund for county Inheritance Tax replacement within the ranges specified in the table below beginning in FY 2005. Necessary replacement funding could vary within these ranges depending upon whether, and by how much, each county's base revenue exceeds the amount guaranteed under current statute. The impact of eliminating the Inheritance Tax on July 1, 2007, is estimated to total approximately \$7.5 M annually beginning in FY 2009. This is the maximum amount of replacement funding guaranteed to counties under the replacement procedure. (See *Explanation of Local Revenues*, below, for explanation of county revenue loss and replacement procedure.)

<b>Fiscal Year</b>	<b>State Expenditures for County Inheritance Tax Replacement</b>
2005	\$255,000 - \$2.1 M
2006	1.4 - 4.1 M
2007	3.2 - 6.2 M
2008	5.2 - 7.5 M
2009 and after	7.5 M

**Explanation of State Revenues:** The bill would lead to a progressively larger reduction in Inheritance Tax revenue from FY 2005 to FY 2009, when it is estimated that the state would no longer receive revenue from the tax. However, the reduction in Inheritance Tax liabilities is expected to increase Indiana Estate Tax revenue slightly in FY 2005 and FY 2006. The Estate Tax offset is expected to decline to zero in FY 2007 as the phaseout of the federal state death tax credit (the Indiana Estate Tax base) is completed. The estimated net revenue loss from the bill is presented in the table below.

<b>Fiscal Year</b>	<b>Inheritance Tax Revenues</b>	<b>Estate Tax Revenues</b>	<b>Net Revenue Increase (Decrease)</b>
2005	(\$24.0 M)	\$328,000	(\$23.7 M)
2006	(48.1 M)	52,000	(48.0 M)
2007	(72.1 M)	0	(72.1 M)
2008	(96.1 M)	0	(96.1 M)
2009 and after	(120.1 M)	0	(120.1 M)

*Background on Inheritance Tax:* The bill phases out the Inheritance Tax over a five-year period by providing an increasing credit against a transferee's Inheritance Tax liability. The credit would apply to transfers made by persons who die on or after specified dates. The credits and applicable dates are presented in the table below. Since the Inheritance Tax does not have to be paid until a maximum of 12 months after the decedent's death (within 9 months of the date of death to receive the 5% early payment discount), the impact of the first-year credit (equal to 20%) likely would not be experienced until FY 2005.

<b>Inheritance Tax Credit</b>	<b>Transfers made from persons dying . . .</b>
20%	After June 30, 2003, and before July 1, 2004
40%	After June 30, 2004, and before July 1, 2005
60%	After June 30, 2005, and before July 1, 2006
80%	After June 30, 2006, and before July 1, 2007
100%	After June 30, 2007

The estimated impact of this change is based on the Revenue Technical Committee's FY 2003 forecast (updated November 14, 2001) for the Inheritance Tax totaling \$140.0 M. The forecast total is a combined amount including both Inheritance Tax and Estate Tax revenue. Based on a five-year (1988-2002) average, 85.8% of the revenue from both taxes is estimated to be attributable to the Inheritance Tax. This suggests that the Inheritance Tax will yield about \$120.1 M and the Estate Tax about \$19.9 M in FY 2003. These forecast totals are utilized as the base for the fiscal impact estimates.

*Background on Estate Tax:* The elimination of Inheritance Tax liabilities would affect Estate Tax revenues. Under current statute, Indiana Estate Tax is owed on the assets of an estate if (1) federal Estate Tax is owed on the estate and (2) the Indiana portion of the state death tax credit for federal Estate Tax purposes exceeds the total Inheritance Tax paid by transferees of the estate. Under the bill, the Indiana Estate Tax would still be limited to estates paying federal Estate Tax, but the Indiana Estate Tax would be equal to the total state death tax credit. Consequently, for some estates the elimination of the Inheritance Tax would result in a compensating increase in the Indiana Estate Tax liability. The estimated impact of the bill on Estate Tax revenues is based on OFMA's Estate Tax database and the Revenue Technical Committee's FY 2003 forecast (updated November 14, 2001) for the Estate Tax totaling \$19.9 M. It is estimated that Estate Tax revenue would otherwise total \$2.2 M in FY 2005 and \$590,000 in FY 2006 after accounting for the phaseout of the federal state death tax credit (the Indiana Estate Tax base). The Estate Tax database consists of 559 estates of decedents who died between July 1, 1997, and June 30, 2000, and that paid Indiana Estate

Tax. The Inheritance Tax changes provided for in the bill increased the Estate Tax liability of the sample by approximately 15% in FY 2005 and 8.8% in FY 2006. As a result, the Inheritance Tax changes are estimated to increase Estate Tax revenue by about \$328,000 in FY 2005 and \$52,000 in FY 2006.

**Explanation of Local Expenditures:**

**Explanation of Local Revenues:** The phaseout of the Inheritance Tax coupled with county Inheritance Tax replacement could potentially result in an annual net revenue loss to counties beginning in FY 2005. This net impact is summarized in the table below. (These estimates will be updated as new forecast totals and new tax data become available.)

<b>Fiscal Year</b>	<b>Inheritance Tax Revenues (Local Share)</b>	<b>State Expenditures for County Replacement</b>	<b>Net Increase (Decrease)</b>
2005	(\$2.1 M)	\$255,000 - \$2.1 M	(\$0.0 - \$1.8 M)
2006	(4.1 M)	1.4 M - 4.1 M	(0.0 - 2.8 M)
2007	(6.2 M)	3.2 M - 6.2 M	(0.0 - 3.0 M)
2008	(8.3 M)	5.2 M - 7.5 M	(840,000 - 3.1 M)
2009 and after	(10.4 M)	7.5 M	(2.9 M)

Currently, counties retain 8% of the Inheritance Tax collected on transfers made by Indiana residents. About 99.1% of Inheritance Tax revenue is derived from the resident Inheritance Tax. Based on the FY 2003 forecast for state Inheritance Tax revenue totaling \$120.1 M, annual county Inheritance Tax revenue is estimated to total about \$10.4 M beginning in FY 2003. It is important to note that a reduction in the amount of Inheritance Tax retained by counties due to the bill may be reimbursed by the state under the replacement provision established by P.L. 254-1997. The replacement provision was established when the Class A exemption was increased on July 1, 1997. The replacement provision guarantees that in each fiscal year each county receives an amount under the Inheritance Tax that is equal to the five-year annual average amount of Inheritance Tax revenue retained by that county from FY 1991 to FY 1997, excluding the highest and lowest year. The maximum amount of county replacement for any year is approximately \$7.5 M. Currently, most counties are retaining more revenue than is guaranteed under this replacement procedure. On average from FY 2000 to FY 2002, counties exceeded their guarantee amounts by about \$3.8 M annually, with annual shortages subject to replacement totaling about \$243,000. With base revenue to the counties totaling \$10.4 M, the revenue loss covered by replacement funds could vary within the ranges specified in the table. To the extent that base revenue is less than the estimate, replacement funding would increase and the net loss due to the bill would decline.

A copy of a spreadsheet showing the amount of Inheritance Tax replacement guaranteed to each county under P.L. 254-1997 is available from the Office of Fiscal and Management Analysis.

**State Agencies Affected:** Department of State Revenue.

**Local Agencies Affected:** Counties.

**Information Sources:** State Revenue Forecast, November 14, 2001. OFMA Inheritance Tax and Estate Tax

databases.

**Fiscal Analyst:** Jim Landers, 317-232-9869